

# Industrial Revitalization Corp. of Japan Moves into Action

By Tani Sadafumi

On Aug. 28 and Sept. 1, the Industrial Revitalization Corp. of Japan (IRCJ) selected its initial set of four companies to receive public restructuring assistance. In an appeal to industry and finance calling for intensive use to be made of the IRCJ, Tanigaki Sadakazu, former minister of state for Industrial Revitalization Corp. (now finance minister), said during a press conference: "We are hopeful that proposals for restructuring candidates will keep coming at a steady pace. The important issue is to judge each case individually, and in so doing open a vista on the future of Japan's economy." Banks, however, in their position as main lenders to struggling companies, have been reluctant to propose candidates for restructuring to the IRCJ. Reservations are also apparent on the part of government concerning interference by the IRCJ in private-sector affairs.

The IRCJ started out April 16 with the objective of resolving excessive debt and oversupply in the economy. Run by a group of specialists, the body has as its president Saito Atsushi, a former vice president of Nomura Securities Co.; Takagi Shinjiro, a professor at Dokkyo University and lawyer with extensive experience in corporate restructuring, serves as chairman of the IRCJ's Industrial Revitalization Committee in charge of determining eligibility for restructuring assistance; and Toyama Kazuhiko, president of consulting firm Corporate Directions, is chief operating officer (COO) and head of the restructuring implementation team.

Subject to restructuring assistance, for example, are companies with otherwise healthy main operations weighed down by excessive debt incurred from resort development during Japan's bubble economy. Additionally, since restructuring is financed with public funds, for a candidate company to be eligible for aid, its survival must be

judged important for Japan's economy at the national or regional level. For companies satisfying these requirements, the IRCJ, in cooperation with the respective main bank, will draft a restructuring plan, and on this basis proceed to acquire claims held by other financial institutions and creditors in the entity to be restructured. The period for purchases of such claims by the IRCJ expires at the end of March 2005. Funding is provided through a government guarantee frame of up to ¥10 trillion established under the national budget for fiscal 2003, with claims acquired under this frame to be sold in the market within three years. The IRCJ is expected to be dissolved by the end of March 2008. Any losses to be recognized at that time because proceeds from sales of claims fall short of acquisition costs will ultimately have to be absorbed by the public.

Corporate rehabilitation, in the natural course of events, should be left to the private sector. However, even in instances where leading banks launch restructuring initiatives, the coordinated action of claim holders among second-tier banks and lower ranking institutions tends to go unachieved, and proceedings to draft a restructuring plan often never get under way despite good prospects for rehabilitation. The establishment of the IRCJ, heavy-handed measure that it was, therefore aimed to resolve through a public initiative the problem of non-performing loans (NPLs) held by financial institutions, or viewed from another perspective, the problem of excessive indebtedness of non-financial companies.

The initial set of companies selected by the IRCJ comprises: (1) DIA Kensetsu Co., a condominium developer and management company headquartered in Tokyo, with shares listed on the second section of the Tokyo Stock Exchange; (2) Kyushu Industrial Transportation Co., a regional bus operator headquartered in Kumamoto; (3)

Usui Department Store, a regional high-class department store located in Koriyama, Fukushima Prefecture; and (4) the venerable Mitsui Mining Co., headquartered in Tokyo, with shares listed on the first section of the Tokyo Stock Exchange.

Despite some variation in the particulars of the rehabilitation plans, which reflects differences in the type of industry and size of the four companies, there are numerous common features. In addition to support from main banks through debt waivers and similar measures, company management, as a matter of principle, will be retired. The IRCJ will acquire the new shares to be issued, and has indicated its intention to assume management control over three of the four companies, with the exception of DIA Kensetsu. The use of debt-equity swaps is particularly noteworthy.

Although debt equity-swaps are common in the United States and Europe, their use is a relatively recent development in Japan. Under the basic structure, a heavily indebted company seeking to financially restructure itself will allot newly issued shares to its creditors in exchange for debt relief. For the borrower company, this entails a lighter debt repayment burden, while creditors may obtain capital gains in excess of the debt relief granted as the value of the shares rises, assuming performance as expected under the rehabilitation plan. In other words, the structure is comparable to a loan drawn in advance on the merits of a future career promotion. In this sense, for those responsible at IRCJ for tailoring measures for each individual case, the rehabilitation plans created since the launch of operations early this May represent the fruit of significant labor.

When the names of the four companies in the initial set were announced, however, the mass media unanimously assessed the selection as "small game," reflecting strong disappointment after the much-trumpeted inception of the

IRCJ as the decisive instrument for Japan's industrial rehabilitation and the inflated expectations that ensued. The two unlisted companies, although familiar names in their regions, are complete unknowns at the national level, and the listed ones can hardly be called prominent, marginalizing the significance of the measure for Japan's economy.

In the fall of 2002, when the concept of the IRCJ was floated, attention moved in on several large corporations among trading companies, distributors and in the construction industry, which were considered potential restructuring candidates. However, financial assistance from the IRCJ implied public interference in management, and in order to prevent this from happening, consolidation plans were hammered out by Nissho Iwai Corp. for Nichimen Corp., for example. The first set of rehabilitation candidates ended up containing only small entities because several large struggling companies opted not to wait for the inception of the IRCJ but took an independent path to reorganization, robbing the IRCJ of showcase examples.

Yet another reason why the first step ended as a small one is banks' negative attitude concerning the activities of the IRCJ. As explained above, if the IRCJ suffers losses, the public will have to absorb them. If this is to be avoided, the IRCJ cannot afford to be lenient and acquire claims at high prices. As a senior executive of a large bank observes warily, "If we were to take the initiative and introduce potential candidates to the IRCJ for consideration, our current position would be exposed and acquisition prices would be beaten down."

Viewed from a different angle, another focal point is the fact that three of the four cases involve public sector creditors. DIA Kensetsu and Kyushu Transportation owe ¥5 billion and ¥8 billion, respectively, to the Organization for Promoting Urban Development affiliated to the Ministry of Land, Infrastructure and Transport. And Mitsui Mining owes ¥70 billion to the New Energy and Industrial Technology Development Organization (NEDO), affiliated to the Ministry of Economy,

Trade and Industry-related Agency for Natural Resources and Energy. Although it is normal for public bodies not to agree to debt waivers, in this instance partial debt forgiveness was granted in view of the good cause perceived in cooperating with a national project like the IRCJ.

From the perspective of banks, it can be said that the IRCJ has the potential to serve as a convenient means for disposing of cumbersome lending engagements. Conversely, people at the IRCJ feel that "cases involving public bodies require an inordinate amount of effort, considering the results." Many expect that in the future the IRCJ will have a steady number of companies introduced to it from the third sector (joint projects between regional public bodies and the private sector), where continuing deterioration in business conditions is frequently noted.

Ever since the concept of the IRCJ was floated in the fall of last year, there has been a question as to the right or wrong of public assistance in rehabilitating private-sector businesses. Looking back at the situation about a year ago, at the time it was Takenaka Heizo who, after assuming responsibilities as minister in charge of financial services in addition to that of economic and fiscal policy, ordered strict asset assessment, cornered Japan's large banks through a concomitant acceleration in the disposal of NPLs, and propagated a hard-landing approach through the infusion of public funds and the de facto nationalization of financial institutions. This handling gave rise to voices from industry and lawmakers warning that "promoting the disposal of NPLs alone will trigger a chain of corporate defaults and fill the streets with unemployed people."

In this setting, the IRCJ was conceived as a forward-looking policy measure. An official involved from the stage of the initial draft proposal for the IRCJ expressed enthusiasm: "We have been expecting and are prepared for criticism as to whether the public sector should interfere in the survival or demise of private-sector businesses. At the same time, the rehabilitation of Japan's economy cannot be achieved without risk taking. In fact, we are not

really concerned about what people will say about us."

Undoubtedly, as this official observes, disclosure of the four recipients of rehabilitation assistance lets the public provided by the four companies will be large enough to make public support imperative. The president of the IRCJ rejected this view at a press conference, using the example of Kyushu Transportation: "What will come from destroying everything? If the entire bus operations in Kumamoto were to be dissolved, the result would be 4,000 unemployed."

Doubts also remain in relation to one of the primary goals of the IRCJ – resolving oversupply. Companies in the general contractor industry and in other business sectors, according to a trend that has become visible, have their banks grant debt waivers and with their financial burdens now alleviated rush to underwrite projects on low bids, harming healthy companies in the process. According to this argument, the IRCJ may simply be extending the lives of companies that should properly exit the market. COO Toyama asserts in response to this claim: "Judgments are made by experienced specialists."

When public funds were injected into Resona Bank, despite some moral compromise as regards shareholder responsibility, the emphasis rested on the ratio between cost and effect. The concept of the IRCJ is essentially the same. There will be no escape from criticism. The only effective counter-argument will be the record of performance to be built step-by-step by the specialist team of the IRCJ. JSTI

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